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Nos. 476 - 477 - 478

In the Supreme Court of the United States

OCTOBER TERM, 1932

D. B. HEINER, COLLECTOR OF INTERNAL REVENUE FOR THE TWENTY-THIRD DISTRICT OF PENNSYLVANIA, PETITIONER

v.

DIAMOND ALKALI COMPANY, A CORPORATION

C. G. LEWELLYN, FORMERLY COLLECTOR OF INTERNAL REVENUE FOR THE TWENTY-THIRD DISTRICT OF PENNSYLVANIA, PETITIONER

v.

DIAMOND ALKALI COMPANY, A CORPORATION

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

INDEX

	Page
Opinions below	2
Jurisdiction	2
Question presented	2
Statutes and regulations involved	3
Statement	3
Specification of errors to be urged	6
Reasons for granting the writ	7
Appendix (statutes and regulations)	13–16

CITATIONS

Cases:	
Apollo Steel Co. v. *Commissioner*, 41 F. (2d) 986, certiorari denied, 282 U. S. 891	8
Blair v. *Oesterlein Machine Co.*, 275 U. S. 220	10
Brown's "Shamrock" Linens v. *Bowers*, 48 F. (2d) 103, certiorari denied, 283 U. S. 865	8, 9
Chalmers Publishing Co. v. *Commissioner*, 1 B. T. A. 629	11
Cleveland Automobile Co. v. *United States* (N. D. Ohio), not officially reported	8
Cramer & King Co. v. *Commissioner*, 41 F. (2d) 24	8
Duquesne Steel Foundry Co. v. *Commissioner*, 41 F. (2d) 995, affirmed, 283 U. S. 799	8
Enameled Metals Co. v. *Commissioner*, 42 F. (2d) 213, affirmed, 283 U. S. 799	8
Ennis Coal Co. v. *United States*, 37 F. (2d) 574	12
Kehaha Sugar Co. v. *Burnet*, 50 F. (2d) 322	8
Live Stock Nat. Bank v. *United States*, 36 F. (2d) 334, certiorari denied, 281 U. S. 760	12
National Bank of Commerce v. *United States*, 39 F. (2d) 434	12
Oak Worsted Mills v. *United States*, 38 F. (2d) 699, affirmed, 282 U. S. 409	8
Railroad Supply Co. v. *Burnet*, 51 (2d) 437	9
Standard Rice Co. v. *Commissioner*, 41 F. (2d) 481	8
Williamsport Wire Rope Co. v. *United States*, 277 U. S. 551	7, 9, 11
Statutes:	
Revenue Act of 1918, c. 18, 40 Stat. 1057, 1093—	
Sec. 234	15
Sec. 301	4
Sec. 327	13
Sec. 328	13
Miscellaneous:	
Treasury Regulations 45—	
Art. 901	15
Art. 911	15

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In the Supreme Court of the United States

OCTOBER TERM, 1932

No. —

(Nos. 4419 and 4426 in the Circuit Court of Appeals)

D. B. HEINER, COLLECTOR OF INTERNAL REVENUE for the Twenty-third District of Pennsylvania, petitioner

v.

DIAMOND ALKALI COMPANY, A CORPORATION

No. —

(No. 4427 in the Circuit Court of Appeals)

C. G. LEWELLYN, FORMERLY COLLECTOR OF INTERNAL REVENUE for the Twenty-third District of Pennsylvania, Petitioner

v.

DIAMOND ALKALI COMPANY, A CORPORATION

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of D. B. Heiner, Collector of Internal Revenue for the Twenty-third District of Pennsylvania, and C. G. Lewellyn, formerly Collector of Internal Revenue for that District, prays that writs of certiorari issue to review

the judgments of the Circuit Court of Appeals for the Third Circuit entered in the above causes on July 26, 1932, upon rehearing granted at the instance of the Diamond Alkali Company, affirming in part and reversing in part the judgments of the District Court for the Western District of Pennsylvania, 39 F. (2d) 645 (Nos. 4419 and 4426, B. of E., 1115; No. 4427, R. 86).[1]

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (Nos. 4419 and 4426, B. of E., 1072–1111; No. 4427, R. 69–82) are reported in 39 F. (2d) 645. The original opinion of the Circuit Court of Appeals appears at No. 4427, R. —, and the opinion of that court upon reargument appears at No. 4427, R. —. These opinions are not yet reported.

JURISDICTION

The judgments sought to be reviewed were entered on July 26, 1932. (Nos. 4419 and 4426, R. —; No. 4427, R.—.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the court below had the power to review the Commissioner's determination of the amount of the profits taxes due from the respondent where that determination was made pursuant to the discretion-

[1] The final Supreme Court records and case numbers not being available the record references herein are to the records in the Circuit Court of Appeals and are identified by the case numbers of that court. The bill of exceptions in Nos. 4419 and 4426 is printed separately, in three volumes.

ary powers confided to the Commissioner by Sections 327 and 328 of the Revenue Act of 1918.

STATUTES AND REGULATIONS INVOLVED

These are set forth in the Appendix, *infra*, pp. 13–17.

STATEMENT

The material facts, most of which were specially found by the District Court (Nos. 4419 and 4426, B. of E., 1072–1092; No. 4427, R. 69–81), are as follows:

The respondent filed income and profits tax returns for the years 1918 and 1919 and paid the taxes due as disclosed by these returns. Thereafter the respondent filed with the Commissioner an application for the computation of its 1918 and 1919 profits taxes under Sections 327 and 328 of the Revenue Act of 1918. The Commissioner granted this application (Nos. 4419 and 4426, B. of E., 1087; No. 4427, R. 375–376), having found that respondent's profits taxes, if determined without the benefit of Sections 327 and 328, would, owing to abnormal conditions affecting its capital or income, work upon it an exceptional hardship, evidenced by the gross disproportion between the tax as computed without the benefit of Section 327 and the tax computed by reference to the representative corporations specified in Sections 328.

In computing respondent's profits taxes under Section 328 the Commissioner determined the ratio of its tax to income for 1918 to be 54.54%, arriving at that ratio on the basis of the ratio of average tax

to average net income of representative corporations engaged in a like or similar trade or business. (Nos. 4419 and 4426, B. of E., 1088.) The ratio of tax to income for the year 1919 was determined by the Commissioner to be 18.31%. (Nos. 4419 and 4426, B. of E., 377; No. 4427, R. 80.) The Commissioner's computation for 1918 indicated a profits tax of $2,084,324.26 and an income tax of $206,039.99, a total tax liability of $2,290,364.25 (Nos. 4419 and 4426, B. of E., 377), whereas by computation of the tax under Section 301 of the 1918 Revenue Act (without special assessment) a profits tax of $2,592,789.30 and an income tax of $140,729.65, a total tax liability of $2,733,518.85, had been determined (Nos. 4419 and 4426, B. of E., 587). For 1919 the Commissioner determined respondent's excess-profits tax to be $709,926.02 together with an income tax of $192,634.09, a total of $902,560.11 (Nos. 4419 and 4426, B. of E., 608), under Section 301 of the Revenue Act of 1918 (without special assessment), whereas the computation under Section 328 showed a profits tax of $495,871.87 with income tax of $214,039.51, a total tax liability of $709,911.38 (Nos. 4419 and 4426, B. of E., 595). The taxes as determined by the Commissioner under Sections 327 and 328 were paid, but the respondent filed claims for refund of such taxes upon the ground that the Commissioner had erroneously disallowed certain deductions, and upon the rejection of said claims instituted these suits. Jury trials were waived in writing. (Nos. 4419 and 4426, B. of E., 3; No. 4427, R. 1.)

Respondent contended in the District Court that its taxable net income for 1918 and 1919 had been overstated by the Commissioner because of his failure to allow certain deductions for those years, and also that the Commissioner had erred in the application of Sections 327 and 328 in determining the ratio of tax to income for the year 1918 to be 54.54% when it should have been but 45%. It was neither charged nor proved that the Commissioner acted fraudulently or arbitrarily in determining the taxes under Sections 327 and 328.

The District Court held that the Commissioner had erred in failing to allow the claimed deductions to the extent of $238,001.09 for 1918 and $49,525.73 for 1919, and thereupon computed the profits taxes for each of said years at the ratio of the reduced net income for each year, which had previously been applied by the Commissioner (54.54% for 1918 and 18.31% for 1919) to the net income as computed by him. (Nos. 4419 and 4426, B. of E., 1089, 1091; No. 4427, R. 80.) Cross appeals were taken from the decision of the District Court with respect to the taxes for 1918, and the Collector appealed from the judgment with respect to the taxes for 1919.

The Circuit Court of Appeals held that the respondent was entitled to additional deductions from

income as follows (Nos. 4419 and 4426, R.—; No. 4427, R.—):

	Additional deductions allowed by Circuit Court of Appeals	Total additional deductions allowed by District Court and Circuit Court of Appeals
1918	$291,732.24	$528,733.33
1919	55,045.70	104,571.43

In its original opinion (Nos. 4419 and 4426, R. —; No. 4427, R. —) that court held that it was without power to review the Commissioner's computation of *profits* taxes under Sections 327 and 328, and allowed respondent a refund only with respect to its *income* taxes. But upon reargument the court held, Judge Thompson dissenting, that the rate (ratio) fixed by the Commissioner under Section 328 should be applied to the reduced net income of the respondent in computing the profits taxes.[2] (Nos. 4419 and 4426, R. —; No. 4427, R. —.)

SPECIFICATION OF ERRORS TO BE URGED

1. The Circuit Court of Appeals erred in undertaking to review the Commissioner's determination of respondent's profits taxes.

2. The Circuit Court of Appeals erred in holding that the application by it of the ratio determined by the Commissioner under the special assessment provisions of the statute, to a reduced net income fixed

[2] The court in its opinion upon the rehearing dealt also with the question of depreciation upon the unamortized cost of certain war facilities. That issue is not raised in this petition.

by the court, for the purpose of computing respondent's profits taxes, did not constitute a usurpation of the discretionary functions confided to the Commissioner by Sections 327 and 328.

3. The Circuit Court of Appeals erred in holding that the so-called "rates of tax" computed by the Commissioner under Section 328 should be applied to the reduced net income in computing respondent's profits taxes.

4. The Circuit Court of Appeals erred in affirming the District Court with reference to the issue of special assessment.

REASONS FOR GRANTING THE WRIT

1. The decision of the Circuit Court of Appeals conflicts with the principles announced in *Williamsport Wire Rope Co.* v. *United States*, 277 U. S. 551. This Court there held that discretionary power had been conferred on the Commissioner to determine whether or not taxpayers are entitled to the benefit of Sections 327 and 328, and also, if entitled to the benefits of those sections, the amount of the tax to be paid, and that such determinations are final and not subject to judicial review in the absence of fraud or similar irregularities. The Circuit Court of Appeals in the instant cases has not only undertaken to revise the Commissioner's determination in the absence of fraud or other irregularity, but has, in effect, undertaken to apply and give effect to Sections 327 and 328 and to exercise the functions which have been confided to the Commissioner. The decision of the Circuit Court of Appeals is probably

inconsistent with its own decisions in *Duquesne Steel Foundry Co.* v. *Commissioner*, 41 F. (2d) 995, affirmed *per curiam*, 283 U. S. 799, and *Cramer & King Co.* v. *Commissioner*, 41 F. (2d) 24. It is also at variance with the principles announced in *Brown's "Shamrock" Linens* v. *Bowers*, 48 F. (2d) 103 (C. C. A. 2d), certiorari denied, 283 U. S. 865, where it was held that the court had no jurisdiction to review the comparative data employed by the Commissioner in computing the tax, upon the mere allegation of error or illegality; *Standard Rice Co.* v. *Commissioner*, 41 F. (2d) 481 (C. C. A. 5th), ruling that the Board had fairly exercised its power of review of the Commissioner's denial of special assessment and that the court had no jurisdiction; *Oak Worsted Mills* v. *United States*, 38 F. (2d) 699 (C. Cls.), affirmed on other grounds, *sub nomine Graham & Foster* v. *Goodcell*, 282 U. S. 409, holding that the Commissioner is empowered to revise his determination of the tax computed by special assessment at any time within the statutory period; and *Cleveland Automobile Co.* v. *United States* (N. D. Ohio), not officially reported, discussing the jurisdiction of the courts to review an alleged overvaluation of inventory when the taxes were computed under the special assessment provisions of the Revenue Act of 1918. See also *Apollo Steel Co.* v. *Commissioner*, 41 F. (2d) 986 (C. C. A. 3d), certiorari denied, 282 U. S. 891; *Enameled Metals Co.* v. *Commissioner*, 42 F. (2d) 213 (C. C. A. 3d), affirmed *per curiam*, 283 U. S. 799; *Kehaha Sugar Co.* v. *Burnet*, 50 F. (2d)

322 (App. D. C.); *Railroad Supply Co.* v. *Burnet*, 51 F. (2d) 437 (App. D. C.).

2. The decision of the Circuit Court of Appeals is erroneous. In its initial opinion the court held that the District Court erred in redetermining the amount of the excess profits tax fixed by the Commissioner by applying the ratio of tax determined by the Commissioner to the reduced net income as determined by the court. In support of this view it invoked the *Williamsport Wire Rope Co.* case and also ~~in~~ *Brown's "Shamrock" Linens* v. *Bowers, supra.* In its subsequent decision the court abandoned its earlier view and, although conceding (No. 4427, R. —) the "bare possibility" that the reduction of net income might have some "conceivable effect" on the selection of the representative corporations contemplated by the special assessment provisions, held that the Commissioner could not, once having found the correct rate, apply it "to an incorrect and false income and produce an unjust tax." (No. 4427, R. —.) In an apparent effort to do what it conceived to be justice in the particular case, the court did indirectly what it could not do directly. The language of Sections 327 and 328, which refer to the *determining* and *computing* of the tax, makes it clear that Congress contemplated special assessment as a method of *computing the tax* and not merely a method of *fixing a rate.* In the *Williamsport Wire Rope Co.* case (pp. 558–559) the Court made it clear that the special functions vested in the

Commissioner by the statute extended to the "computation" of the tax "in all cases."

Moreover, the decision of the Circuit Court of Appeals amounts to an application of Section 328 without the performance of the preliminary tasks prescribed therein. The statute specifically defines the various factors which are to be employed by the Commissioner in the selection of comparatives and computation of the tax by means of special assessment. One of these factors is "net income," while another is "profits per unit of business transacted." The court can not disregard any one of these factors without affecting the result and in so doing it does precisely that which is not permitted under the statute. With the alteration in the taxpayer's net income the court sweeps away an indispensable factor upon which the Commissioner's computation was based. It may be that an entirely different group of comparatives would be selected by the Commissioner in view of such changes, and it is quite possible that with the reduction in net income the abnormality with respect to the respondent's capital and income might entirely disappear, together with all justification for allowing special assessment.

The decision of this Court in *Blair* v. *Oesterlein Machine Co.*, *supra*, established that the discretionary authority of the Board of Tax Appeals in matters of special assessment is coextensive with that vested in the Commissioner. The fact that the discretion of the Commissioner is subject to review by the Board

is believed to constitute a sufficient safeguard for the taxpayer who seeks the privilege of special assessment,[3] in view of the fact that the taxpayer may appeal to the courts in case of "fraud or other irregularities." *Williamsport Wire Rope Co.* v. *United States*, 277 U. S. 551, 562. Furthermore, where application has been made for special assessment and the Commissioner fixes a net income in excess of that returned by the taxpayer, it is customary to afford the taxpayer an opportunity to withdraw his request for special assessment.[4] Cf. *Chalmers Publishing Co.* v. *Commissioner*, 1 B. T. A. 629.

There is nothing in the record to warrant the conclusion that the action of the court below was based upon fraud or other irregularity on the part of the Commissioner. The courts have consistently recognized that this exception imports action by the Commissioner which is plainly arbitrary or involves a

[3] The respondent, by failing to seek a review before the Board, waived that right. This Court has held that the determinations of the Board, with reference to assessment under Section 328, are not reviewable in the courts. The same reasons require a holding that the Commissioner's determinations are final when no review is sought before the Board.

[4] It has not been established that the taxes were overpaid. At our request the Bureau of Internal Revenue has computed the profits taxes which would be due under the application of the normal method of Sec. 301 to the net income and invested capital as revised by the allowances in respect of depreciation and amortization granted by the court below. This shows that under such normal computation a difference of $37,143.31 for 1918 and $181,805.91 for 1919 would result in favor of the Government, as compared with the taxes as fixed by the Commissioner under special assessment.

clear abuse of discretion. Mere error upon the part of the Commissioner is not sufficient. *Live Stock Nat. Bank* v. *United States*, 36 F. (2d) 334 (C. C. A. 8th), certiorari denied, 281 U. S. 760; *National Bank of Commerce* v. *United States*, 39 F. (2d) 434 (C. C. A. 9th); *Ennis Coal Co.* v. *United States*, 37 F. (2d) 574 (C. C. A. 4th).

3. The question presented is involved in a considerable number of cases now pending involving taxes in the aggregate in excess of $3,000,000. Furthermore, the finality of the determination of the Commissioner, where made pursuant to statutes conferring upon him broad administrative powers involving the exercise of his discretion, is a matter which is of general importance in administering the taxing laws. While the taxing Act here involved is that of 1918, in its broader aspect the question is involved in other phases of the administration of later Revenue Acts in connection with the discretionary powers confided to the Commissioner.

Wherefore, it is respectfully submitted that this petition should be granted.

THOMAS D. THACHER,
Solicitor General.

OCTOBER, 1932.

APPENDIX

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1093:

SEC. 327. That in the following cases the tax shall be determined as provided in section 328:

* * * * *

(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital, nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

SEC. 328. (a) In the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of $3,000) for the taxable year, as the average tax of representative corporations engaged in

a like or similar trade or business, bears to their average net income (in excess of the specific exemption of $3,000) for such year. In the case of a foreign corporation the tax shall be computed without deducting the specific exemption of $3,000 either for the taxpayer or the representative corporations.

In computing the tax under this section the Commissioner shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are, as nearly as may be, similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

(b) For the purposes of subdivision (a) the ratios between the average tax and the average net income of representative corporations shall be determined by the Commissioner in accordance with regulations prescribed by him with the approval of the Secretary.

* * * * *

(c) The Commissioner shall keep a record of all cases in which the tax is determined in the manner prescribed in subdivision (a), containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, and the amount of invested capital as determined under such subdivision. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257.

Treasury Regulations 45:

ART. 901. *Treatment of special cases.*—In the cases specified in section 327 of the statute the tax will be specially determined under the provisions of section 328, but the tax will not ordinarily be computed under section 328 merely because the corporation's form or manner of organization, or the limitations imposed by section 326, result in a greater tax than would otherwise be payable. A corporation which comes within the provisions of subdivision (d) of section 327 may make application for assessment under the provisions of section 328, which application shall be attached to its return in the form of a statement setting forth in full: (a) the reasons why the tax should be so determined; (b) the facts upon which such reasons are based; (c) an exact description of each trade or business or important branch of a trade or business carried on by it; (d) a statement of the invested capital and net income for each year since the beginning of the pre-war period; and (e) a statement showing the amount of gains, profits, commissions, or other income derived on a cost-plus basis from Government contracts made after April 5, 1917, and before November 12, 1918, and showing the per cent which such income is of the total income of the corporation. See sections 1 and 326 and Articles 831–871 and 1510.

ART. 911. *Computation of tax in special cases.*—In the cases specified in section 327 of the statute the tax is to be computed by comparison with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are engaged in a like or similar trade or business and similarly circumstanced. The provisions of section 328 do not permit the determination of a general average for any trade or

business. In each case which comes under the provisions of section 327 the Commissioner will determine, as nearly as may be, the group or class of corporations with which the corporation should be compared and the amount which bears the same ratio to the net income of the corporation (in excess of the specific exemption of $3,000) for the taxable year as the average tax of such representative corporations bears to their average net income (in excess of the specific exemption of $3,000) for such year. The comparison will take account of similarity with respect to gross income, net income, profit per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

U. S. GOVERNMENT PRINTING OFFICE: 1933